LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 6989 **DATE PREPARED:** Dec 29, 2000
BILL NUMBER: SB 208 **BILL AMENDED:**

SUBJECT: Phase-Out of Inheritance Tax.

FISCAL ANALYST: Jim Landers
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FUNDS AFFECTED: **X** **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill phases out the Inheritance Tax over a five-year period beginning with transfers made by decedents who die on or after July 1, 2001. The bill provides an increasing credit against the Inheritance Tax due. The bill also provides that for a person who dies after June 30, 2005, there is no Inheritance Tax imposed on transfers made by that person. The bill repeals the Inheritance Tax on July 1, 2008. The bill also amends the Indiana Estate Tax formula and provides that the amended formula applies to the estate of a person who dies after June 30, 2005. The bill also makes conforming amendments.

Effective Date: July 1, 2001; July 1, 2008.

Explanation of State Expenditures: *State Department of Revenue:* Once the Inheritance Tax is completely phased out, there could be a savings to the state from a reduction in staff in the Inheritance Tax Section of the State Department of Revenue. The December 2, 2000, state manning table indicates that the Inheritance Tax Section employs 17 staff members with an annual salary cost of $456,000. Since staff members would still be needed to process returns as the Inheritance Tax is phased out and since an estimate could not be made of the reduction in filings during each year of the phase-out, a specific savings due to staff reductions could not be estimated.

County Inheritance Tax Replacement: In addition to eliminating Inheritance Tax revenue to the State, the bill would, over the same five-year period, eliminate the resident Inheritance Tax revenue retained by the counties. The revenue loss to counties is estimated to be approximately $2.2 M statewide during FY 2003. As a result of the revenue loss, the bill would increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The maximum amount of county replacement for any year is $7,452,000. The estimated amounts that would be paid to counties by the State for Inheritance Tax replacement beginning in FY 2003 are specified below in Table 1. The impact on the state General Fund in the initial year or two of the phase-out may not equal the revenue loss to the counties since most are retaining more revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in the table below assumes that the revenue loss to the counties will be fully reimbursed by the state until FY 2006 when the county replacement cap of $7,452,000 is reached. In addition, since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the impact that the bill may have on county replacement would be somewhat delayed.

TABLE 1

Fiscal Year	State Expenditures for County Replacement
2003	$2,201,739
2004	$4,403,478
2005	$6,605,217
2006	$7,452,000
2007	$7,452,000

Explanation of State Revenues: The bill would lead to a progressively larger reduction in revenue from the Inheritance Tax from FY 2003 to FY 2007 when it is estimated that the state would no longer receive revenue from the tax. In addition, the bill could potentially lead to an increase in revenue from the Estate Tax. The bill could reduce Inheritance Tax revenue by an estimated $25.5 M in FY 2003. The bill could also increase Estate Tax revenue by an estimated $9.73 M in FY 2003. The net impact of the bill on state revenue is estimated to be a loss of approximately $15.3 M in FY 2003. Further, the impact of state expenditures on county replacement increases the estimated loss to the state (net revenue loss plus county replacement expenditures) to approximately $17.97 M in FY 2003. The estimated impact of the bill on Inheritance Tax and Estate Tax revenue and the net loss to the state including county replacement funding is presented below in Table 2.

TABLE 2

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	Less: State Expenditures for County Replacement	Net Increase (Decrease)
2003	($25,500,000)	$9,727,457	($2,201,739)	($17,974,282)
2004	($51,000,000)	$19,454,913	($4,403,478)	($35,948,565)
2005	($76,500,000)	$29,182,370	($6,605,217)	($53,922,847)
2006	($102,000,000)	$38,909,827	($7,452,000)	($70,542,173)
2007	($127,500,000)	$48,637,283	($7,452,000)	($86,314,717)

Background on Inheritance Tax: The bill phases out the Inheritance Tax over a five-year period by providing an increasing credit against a transferee's Inheritance Tax liability. The credit would apply to transfers made by persons who die on or after specified dates. The credits and applicable dates are presented below in Table 3. Since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the full impact of the first-year credit (equal to 20%) likely would not be experienced until FY 2003.

TABLE 3

Inheritance Tax Credit	Transfers made . . .
20%	After June 30, 2001 and before July 1, 2002
40%	After June 30, 2002 and before July 1, 2003
60%	After June 30, 2003 and before July 1, 2004
80%	After June 30, 2004and before July 1, 2005
100%	After June 30, 2005

The estimated revenue loss is based on the Revenue Technical Committee's FY 2003 forecast for the Inheritance Tax equal to $150 M. This total includes revenue from the Estate Tax estimated to be approximately 15% based on FY 2000 collections. This suggests that Inheritance Tax revenue is forecast at $127.5 M. Thus, the revenue loss for FY 2003 is estimated to be $25.5 M (20% of the FY 2003 forecast) and the revenue loss from the complete elimination of the Inheritance Tax is estimated to be $127.5 M beginning in FY 2007.

Background on Estate Tax: The reduction in Inheritance Tax liabilities for some taxpayers could potentially have an impact on Indiana Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the federal state death tax credit (against the federal Estate Tax) exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an Office of Fiscal and Management Analysis (OFMA) database of Estate Tax returns relating to a decedent who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. It is assumed that the sample is representative of the universe of estates paying the Indiana Estate Tax. The 20% Inheritance Tax credit provided for in the bill led to a 43% increase in the Estate Tax liability of the sample. Based on the FY 2003 revenue forecast and FY 2000 collections, Estate Tax revenue is estimated to be $22.5 M. As a result, the revenue gain in FY 2003 is estimated to be approximately $9.73 M. Elimination of the Inheritance Tax led to a 216% increase in the Estate Tax liability of the sample. Thus, the revenue gain from the Estate Tax in FY 2007 is estimated to be $48.64 M.

Explanation of Local Expenditures:

Explanation of Local Revenues: The phase-out of Inheritance Tax is estimated to result in a net revenue loss to counties beginning in FY 2006. The impact on the counties is presented below in Table 4.

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The estimated revenue loss statewide to counties beginning in FY 2003 is specified below in Table 4. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. Table 4 also specifies the amount of replacement funding the counties will receive beginning in FY 2003. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. Therefore, a reduction in tax retained by a county due to the bill would be reimbursed only to the extent that the changes made by the bill cause the amount of tax revenue retained by the county to fall below its guaranteed amount. Currently, most counties are retaining more Inheritance Tax revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in Table 4 assumes that the revenue loss to the counties will be fully reimbursed by the State until FY 2006 when the replacement cap of $7,452,000 is reached. A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

TABLE 4

Fiscal Year	County Inheritance Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2003	($2,201,739)	$2,201,739	$0
2004	($4,403,478)	$4,403,478	$0
2005	($6,605,217)	$6,605,217	$0
2006	($8,806,957)	$7,452,000	($1,354,957)
2007	($11,008,696)	$7,452,000	($3,556,696)

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, December 19, 2000.
Bill Reynolds, Indiana Department of State Revenue, 232-2075.
OFMA Inheritance and Estate Tax Databases.
OFMA County Replacement Spreadsheet.